



State of South Carolina Office of the Governor

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May 11, 2010

The Honorable Robert W. Harrell, Jr.
Speaker of the House of Representatives
Post Office Box 11867
Columbia, South Carolina 29211

Dear Mr. Speaker and Members of the House:

I am hereby vetoing H. 3584, R. 193, which increases the tax on cigarettes by 50 cents per pack and takes an additional \$1.3 billion out of the South Carolina economy over the next decade. As in past years, this decision has not come easy as I've spoken with passionate advocates whom I respect on both sides of the issue over the last several weeks.

Yet we are where we have always been. We continue to heartily back proposals to increase the cigarette tax, and we continue to insist that this tax hike be coupled with commensurate tax relief in order to fuel our state's economy and spur job creation. And while our administration does not begrudge those in the Legislature who have – in the face of a certainly challenging budget year – been tempted to raise taxes and grow government spending, this penchant for plucking dollars from the private sector and giving them to government, we believe, represents an addiction to spending that will have long-term consequences for our state's fiscal health.

Indeed, this addiction to spending has already had disastrous effects. After growing state government spending by an unsustainable 40 percent from 2004 to 2008, the state budget has now been whittled back from over \$7 billion to around \$5 billion. Yet what's forgotten is that total state spending, including federal funds and fees paid by South Carolinians, has actually increased by 14.5 percent since 2007. So instead of following the belt-tightening lead of families across the state by doing more with less, state government has actually expanded its reach into the pockets of taxpayers and to all corners of our state.

In our desire not to raise the overall tax burden on South Carolinians, there are many tax cuts that could offset raising cigarette taxes, and our proposal has been a simple one. Reduce the personal income tax burden on working South Carolinians because better spending decisions are usually made in their houses versus the State House. Though we have made some progress on reducing

the individual income tax burden on families in this state, our income tax rates continue to punish even the smallest success.

First, the current tax structure still largely resembles the same rate we had 60 years ago. At that time, former Sen. Strom Thurmond was still a freshman in the U.S. Senate and computers took up floors, not desktops. Yet, the annual median income meant that working families were near the bottom of the tax brackets. Today, we have what economist Dr. Russ Sobel calls, “the highest flat rate income tax in the U.S.”

Tax Rate	Beginning Income (1959)	Beginning Income (2008)	1959 Brackets Adjusted for Inflation
2.5%	\$0	NA	\$0
3%	\$2,000	\$2,670	\$14,797
4%	\$4,000	\$5,340	\$29,595
5%	\$6,000	\$8,010	\$44,392
6%	\$8,000	\$10,680	\$59,189
7%	\$10,000	\$13,350	\$73,986

As you can see in the chart above, the income triggers in our tax code have changed very little over the past 50 years, and it is demanding far more from South Carolinians than when it originally started. In 1959, the median family income was \$3,821, which meant the average South Carolina family paid in the three percent income tax bracket. In 2008, the median family median income was \$52,913. So, even after deductions that have been added over the years, the average South Carolina family qualifies for the highest income tax bracket. This will only continue to worsen because our tax brackets are indexed at half the rate of inflation, adding more “top earners” to our tax rolls every year. By doing nothing each year, we effectively continue to raise taxes on working South Carolina families.

Second, when confronting a budget shortfall, tax increases should be a last resort. As we offered during the budget debate last year and again this year, the effect of Washington’s stimulus solution was merely to kick the can down the road on tough decisions. While we’ve withstood wave after wave of budget cuts, the budget debate next year will be even harder as policymakers come to terms with a \$1.2 billion budget hole with stimulus funds spent.

Instead, we should use this opportunity to make reforms to our government and design a leaner, more efficient model going forward that will cost our citizens less and deliver necessary services. Government already costs South Carolinians nearly 140 percent of the national average. Through a series of budget cuts, we have a government that remains larger, duplicative, and inefficient, just not as well funded.

In my most recent Executive Budget, we’ve proposed a series of measures to save \$250 million. We don’t believe those are the only solutions, but they are a good starting point. For instance, if we consolidated school districts, we could put \$25 million directly into the classrooms around the state. We have proposed consolidating the administrative functions of the Technical College

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System that would generate roughly \$20 million in budget savings. Representative Garry Smith proposed closing the Commission on Human Affairs, whose functions are either or could be performed by the Secretary of State's office. The proposal came close to being adopted by the House, but fell short by a few votes. The ideas are there and we should be working on reducing those costs first rather than demanding more from our taxpayers.

Third, tax burdens matter in being able to remain competitive in an increasingly competitive environment. With another budget hole next year, the appetite to raise taxes will become even greater. We cannot be sure where the tipping point is on tax increases, for usually when it happens, it is too late. Two examples of that are north of us on the I-95 corridor, Maryland and New Jersey. In 2008, Maryland passed an income tax increase that forced one in eight of the taxpayers to simply leave the state. According to Bank of America, the State of Maryland lost \$1 billion of its net tax base as a result of the migration out of state.

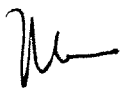
Similarly, Boston College's Center on Wealth and Philanthropy released a report this year examining wealth and charitable giving in New Jersey from 1999 to 2008. The study indicated that from 1999 to 2003, \$98 billion of capital came to the state due to in-migration. In the subsequent four years, New Jersey lost \$70 billion in personal wealth, lowering the taxable wage base. According to the researchers, the catalyst was an increase in taxes that drove money to neighboring lower tax states, New York and Pennsylvania. The third most popular destination was Florida, where there is no income or estate tax.

Fourth, this cigarette tax increase will not solve the health care problem in South Carolina. According to the Office of State Budget, the revenue from this increase will fall short of covering Medicaid growth in less than two years. With the recent passage of ObamaCare legislation in Washington, D.C., almost half a million South Carolinians will be added to the state's Medicaid rolls, costing state taxpayers an additional \$914 million over the next decade. More comprehensive, market-based health care reform is necessary, and indeed this tax hike may end up exacerbating the current problem by pushing needed reform that much further down the road.

If the General Assembly sends me legislation that increases the cigarette tax, but offsets it with cuts in other places, I would sign it immediately. I encourage you and your colleagues to reject the notion that we can ask more from our taxpayers without delivering lower cost government and encouraging economic activity. We remain committed to working with you and the General Assembly to accomplish these goals in the weeks and months ahead.

For these reasons, I am vetoing and returning without my signature H. 3584, R. 193.

Sincerely,



Mark Sanford